

**TENNESSEE DEPARTMENT OF REVENUE  
REVENUE RULING # 00-33**

**WARNING**

**Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.**

**SUBJECT**

Application of the venture capital fund exemption to Tennessee's franchise, excise taxes.

**SCOPE**

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

**FACTS**

Parent LLC, a Tennessee Limited Liability Company, owns one hundred percent (100%) of the outstanding stock of Subsidiary Corp., a Tennessee Corporation. Parent LLC is the sole limited partner and Subsidiary Corporation is the sole general partner of Subsidiary LP, a Delaware Limited Partnership. Subsidiary Corp. and Subsidiary LP are the general partners of a number of limited partnerships collectively referred to as the Investment Partnerships, but they do not serve together as general partners on any of the Investment Partnerships.

Parent LLC is a Registered Investment Advisor providing a full range of financial services for its clients, which consist of both individual and institutional investors. In order to provide a customized investing outlet for its client, Parent LLC, through Subsidiary Corp. and Subsidiary LP, formed the Investment Partnerships. Subsidiary Corp. manages and serves as the general partner of one of the Investment Partnerships. Subsidiary LP manages and serves as the general partner of the other Investment Partnerships.

The Investment Partnerships were formed for the exclusive purpose of buying, holding, and/or selling (on their own behalf) interests in unrelated and non-publicly traded investment limited partnerships that, in turn, invest exclusively in securities such as stocks, bonds, options, derivatives, etc. The Investment Partnerships also provide their clients with a diversified pool of assets in which to invest. Typically, the limited partnership investments have high minimum investment requirements in excess of \$1 million. By commingling their funds, the clients of the Investment Partnerships have the ability to access limited partnerships to which they might not otherwise have access on an

individual basis. In excess of ninety-nine percent (99%) of the Investment Partnerships' capital is supplied by Parent LLC's individual and institutional clients.

Prior to the enactment of the 1999 Tennessee Excise Tax, the Investment Partnerships' income was not subject to tax at the entity level. With certain exemptions, including the exemption for venture capital funds, Public Chapter 406 of the Public Acts of 1999 subjects limited partnerships doing business in Tennessee to Tennessee franchise, excise taxation.

## **QUESTION**

Do the Investment Partnerships qualify for the venture capital fund exemption from Tennessee franchise, excise taxation?

## **RULING**

Yes.

## **ANALYSIS**

T.C.A. § 67-4-2008(5) provides that venture capital funds are exempt from the payment of excise tax if the fund meets the following parameters:

[it] is a limited liability company, a limited liability partnership, or limited partnership, formed and operated for the exclusive purpose of buying, holding and/or selling securities, including debt securities, primarily in non-publicly traded companies on its own behalf and not as a broker, and the capital of which fund is primarily derived from investments by entities and/or individuals which are neither related to nor affiliated with the fund.

T.C.A. § 67-4-2008(5).

Section 18(a)(5) of the Public Chapter 982 of the Public Acts of 2000 amends T.C.A. § 67-4-2008(5) as follows:

(a) There shall be exempt from the payment of the excise tax levied under this part the following:

(1) . . .

(2) . . .

(3) . . .

(4) . . .

(5) Venture capital funds; provided, that for purposes of this part, a venture capital fund is a limited liability company, limited liability partnership, or limited partnership, formed and operated for the exclusive purpose of buying, holding and/or selling securities, including debt securities, primarily in non-publicly traded companies on its own behalf and not as a broker, and the

capital of which fund is primarily derived from investments by entities and/or individuals which are neither related to nor affiliated with the fund. For purposes of this subdivision, the following provisions shall apply:

(A) I.R.C. Section 267(b) and (f) and any federal regulations applicable thereto, as they may be amended from time to time, shall be used to determine whether entities and/or individuals are “related”.

(B) “Affiliated” means entities that are part of an affiliated group as defined in I.R.C. Section 1504(a) and any applicable federal regulations thereto, as they may be amended from time to time.

(C) “Primarily”, as used in this subdivision, means over fifty percent (50%).

(D) “Non-publicly traded companies” means any business entity that is not a “publicly traded company”, as defined by subdivision (E) below.

(E) A “publicly traded company” is any company that is traded on:

(i) a national securities exchange registered under Section 6 of the Securities Exchange Act of 1934 or exempted from registration under such Act by 15 U.S.C. 78f because of the limited volume of transactions;

(ii) a foreign securities exchange operating under principles analogous to a national securities exchange;

(iii) a regional or local exchange;

(iv) an interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise; or

(v) on a secondary market or the substantial equivalent thereof, if taking into account all of the facts and circumstances, the owners are readily able to buy, sell or exchange their ownership interest in a manner that is comparable, economically, to trading on an exchange.

Section 18(a)(5) of Public Chapter 982 of the Public Acts of 2000.

The amendment does not alter the way the statute was administered prior to the amendment. Instead, the amendment simply provides definitions for certain of the terms contained in the body of the exemption.

It is without issue that the Investment Partnerships satisfy the first criteria of exempt venture capital funds because they do business as Tennessee limited partnerships. Therefore, the Investment Partnerships will be considered as exempt venture capital funds if (1) they are formed and operated for the exclusive purpose of trading in securities of primarily non-publicly traded companies on their own behalf, and (2) their capital is primarily derived from investments by entities and/or individuals that are neither related nor affiliated with the fund.

The Investment Partnerships are described as buying, holding, and/or selling (on their own behalf) interests in unrelated limited partnership that, in turn, invest in securities such as stocks, bonds, options, derivatives, etc. Since the Investment Partnerships limit their investments to investments in non-publicly traded limited partnerships, they satisfy the criteria of investing in primarily non-publicly traded companies. Therefore, the

Investment Partnerships will meet the second requirement of exempt venture capital funds if the limited partnership interests in which the Investment Partnerships invest are considered to be securities.

The word “securities” is defined in T.C.A. § 67-4-2004(19) as follows:

United States treasury securities, obligations of United States government agencies and corporations, obligations of state and political subdivisions, corporate stock and other securities, participation in securities backed by mortgages held by the United States or state government agencies, loan backed securities and similar investments.

T.C.A. § 67-4-2004(19). (emphasis added).

Black’s Law Dictionary provides further guidance by defining a security as “an interest based on an investment in a common enterprise rather than direct participation in the enterprise.” Black’s Law Dictionary, 7<sup>th</sup> Ed. 1999. A debt security is defined as “any security that is not an equity security” and an equity security is defined as “a security representing an ownership in a corporation, such as a share of stock.” *Id.* Since Tennessee law includes in its definition of a security the words *corporate stock and other securities*, there is no sound reason why interests in a limited partnership should be treated differently than shares of stock in a corporation. Both are equitable securities in that limited partnership interests as well as shares of corporate stock evidence an ownership interest in a particular enterprise that is based on an investment, rather than direct participation, in the enterprise. Therefore, a limited partnership interest constitutes a security for purposes of the exemption. Thus, the limited partnerships that the Investment Partnerships invest in are considered securities under T.C.A. § 67-4-2004(19) and the Investment Partnerships satisfy the second requirement of the venture capital fund exemption.

Finally, to be considered as exempt venture capital funds the Investment Partnership’s capital must be “primarily derived from investments by individuals and/or entities which are neither related to nor affiliated with the fund.” Section 18(a)(5) of Public Chapter 982 of the Public Acts of 2000. Section 18(a)(5)(B) defines “affiliated” to mean entities that are part of an affiliated group as defined in I.R.C. 1504(a). Section 18(a)(5)(A) to determine whether entities or individuals are “related.” Here, more than 99% of the Investment Partnership’s capital is supplied by Parent LLC’s individual and institutional clients. Those individuals or entities are not affiliated with the fund as contemplated by Section 18(a)(5)(B) because they are not a part of the same affiliated group. Parent LLC’s individual and institutional clients are not “related” because I.R.C. Section 267(b) and (f) does not include members of a partnership and the partnership itself as related persons.

The Investment Partnerships satisfy all the criteria set forth in T.C.A. § 67-4-2008(5) and as a result are venture capital funds that are exempt from Tennessee excise taxation. Furthermore, since the Investment Partnerships are exempt from excise taxation, they are also exempt from franchise taxation under T.C.A. § 67-4-2105(a).

Steven B. McCloud  
Tax Counsel

APPROVED: Ruth E. Johnson  
Commissioner

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